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International Economic & Energy Weekly

25X1

7 June 1985

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7 June 1985

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International Economic & Energy Weekly [redacted] 25X1

7 June 1985

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International Economic & Energy Weekly 25X1

Synopsis

International Economic & Energy Weekly

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7 June 1985

Perspective

Indian Economy on the Eve of Rajiv Gandhi's Visit

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Prime Minister Rajiv Gandhi during his visit to the United States next week will probably highlight India's long-term economic achievements and recent policy reforms. Wary of India's coming balance-of-payments strains, Gandhi's team can be expected to argue for US support for Indian borrowing from multilateral institutions to bolster his liberalized policies. Gandhi also hopes to attract US business interest in supplying advanced technology to make Indian industry more productive. 25X1

Agriculture has been a major success story. Largely because of the Green Revolution, the danger of widespread famine has been eliminated, and New Delhi has become an intermittent exporter of foodgrains. Nonetheless, Gandhi is facing some important challenges. The Green Revolution has not yet reached vast areas of the country, and one-third of the population remains undernourished because they cannot afford an adequate diet. Gandhi will have to grapple both with the economic costs and the political implications of a farm sector increasingly politicized by dependence on subsidies. 25X1

Rajiv Gandhi's policies have accelerated a cautious economic liberalizaton under way since 1980. India's extensive industrial base has developed during decades of protection from domestic and international competition. Returns on this substantial investment, however, have been poor, and capacity utilization is low. Driven by his interest in technology and productivity, Gandhi has further eased government restrictions on private production and investment, especially for the electronics industry. Personal and corporate tax rates have been lowered and imports of sophisticated technology are encouraged. He has also pushed the bureaucracy to expedite decisions that affect business, although he has made it clear that he intends for the government to retain control of the economy. These moves have fueled optimism among corporate leaders, who are now actively planning new investments and seeking increased cooperation with US and other Western business. 25X1

Gandhi's policy reforms are supported by a temporarily buoyant economy. Ample stocks of foodgrains provide a cushion even if this summer's monsoon rains are poor. Foreign exchange reserves are now adequate, largely because of past financial support from the International Monetary Fund and a lower oil import bill, the result of an increase in domestic crude oil production. 25X1

Foreign payments strains are likely to increase significantly before the end of the decade. Expansion of the economy will require faster growth in imports of fertilizer, petroleum, and capital goods, while payments to the IMF and military suppliers are already scheduled to rise sharply. New Delhi is unlikely to seek relief through a substantial increase in commercial borrowing. Gandhi

has not abandoned New Delhi's traditional emphasis on self-reliance, which implies a willingness to sacrifice opportunities for growth in order to reduce India's vulnerability to changes in the policies of other countries. 25X1

Gandhi will likely cite India's political stability as a feature that should be attractive to foreign business. New Delhi's management of explosive social tensions within a democratic framework has been a formidable achievement. As the country becomes more economically interdependent, however, growing caste and religious violence threaten to have a greater impact on the national economy. 25X1

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India: The Continued Success of the Green Revolution [1]

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One of India's major economic success stories has been the Green Revolution in agriculture—the adoption of high-yielding seed varieties (HYVs), chemical fertilizers, and expanded irrigation. India has been able to achieve foodgrain self-sufficiency, export wheat, and improve rural incomes because of the Green Revolution. The high cost of the new farm technologies have caused agricultural subsidies to soar, however, and led farmers to join independent farm "unions" to lobby for higher commodity prices and more input cost supports. Because 65 percent of India's population is employed in agriculture, we judge that providing incentives for increased crop production while keeping growing subsidies in check will be a major challenge for Prime Minister Rajiv Gandhi's administration.

Rising Production

Since the mid-1960s, when the Green Revolution farm technologies were first introduced, foodgrain production has risen over 50 percent. The rapid spread of the new techniques, increased irrigation, and a dramatic rise in chemical fertilizer consumption have been major factors leading to record crops over the past two years. Wheat, to which HYVs were first adapted, has led the way. As a result, the economic impact favored the wheat-growing north. The new surge in production increased national stocks and stimulated exports of nearly 1 million metric tons of wheat to the USSR, Romania, and the World Food Program.

Rice, India's major foodgrain, initially suffered from the lack of effective high-yield varieties suitable to Indian tastes and production conditions. Now, however, more areas are being cultivated with high-yielding varieties of rice than of wheat. In our view, the greatest potential for increased rice production is in the eastern states. This region, however, has been plagued by unreliable irrigation, highly fragmented landholdings, a poor transportation network, and limited access to agricultural credit and technical services. Even so, official Indian data suggest that the extension of high-yielding rice varieties since the early 1970s has been brisk—a rate over twice as fast as that in south India, the country's other major ricegrowing region.

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Higher yielding varieties of commercial crops such as cotton and peanuts have also shown promise; for example, since the late 1960s hybrids have boosted average yields, 43 percent for cotton and 12 percent for peanuts India's major oilseed crop. With the emphasis on irrigated crops considerably less effort has been devoted to developing improved varieties for India's vast rain-fed areas—nearly 70 percent of the cultivated land—leading to stagnant yields for certain coarse grains and protien-rich beans.

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Higher Costs, Higher Subsidies

Although the Green Revolution has been successful in raising agricultural production, it also has been expensive. The new farm technologies require increased use of costly inputs such as chemical fertilizers, hybrid seeds, and pesticides, as well as diesel fuel and electricity to power irrigation pumps. Rising production costs, combined with sluggish commodity prices, have hit hardest at India's economically vulnerable and increasingly politically active small and middle-sized land holders.

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Beginning in the 1960s, New Delhi initiated an extensive subsidy system to control production costs, stimulate production, and keep food prices in

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Percentage of Cultivated Land in High-Yielding Variety (HYV) Foodgrains in India, 1980-81

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Keys to Success

The success of the Green Revolution in increasing foodgrain production was, in our view, the result of investment in irrigation, appropriate agricultural price policies, research, and the maintenance of privately owned and operated family farms:

- *Since the late 1960s, increased public and private investment has nearly doubled India's gross irrigated area, significantly enhancing the potential for agricultural growth.*
- *Agricultural policies that emphasized appropriate commodity support prices, production subsidies, and agricultural research—developed with US assistance—have enabled farmers to reduce risk and speed up adoption of high-yielding varieties.*
- *Private initiative on the part of India's numerous small farmers, who were quick to respond to incentives, accelerated the spread of the Green Revolution.*

check. Over the past few years, higher farm production and food storage costs have become an increasing burden on Indian finances. The FY 1985/86 budget projects food and fertilizer subsidies alone—state governments subsidize irrigation rates, power, rural credit and development programs—at over $2 billion, a sum nearly equal to the estimated overall budget deficit.

Press reports indicate that Gandhi's new agriculture policy probaly will call for a reduction of some farm subsidies, but, because New Delhi is reluctant to antagonize farmers, we judge that a sustained reduction will be politically difficult. In 1984—an election year—the federal government contributed to the subsidy problem by raising average real foodgrain procurement prices over 7 percent and allowing fertilizer subsidies to double. There are no plans to roll back these subsidies in the FY 1985/86 budget.

Richer But Less Stable Villages

Contrary to initial fears of many Indian and Western academics, the Green Revolution appears actually to have strengthened the economic position of small farmers and rural laborers. One major reason is that over 90 percent of those owning irrigated land—a precondition for the adoption of high-yielding varieties—are small farmers with less than 10 acres in holdings. Recent academic studies also suggest that higher real wages and a near doubling of employment opportunities have raised farm labor income in areas affected by the Green Revolution.

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Nonetheless, we believe that the rapid economic change has had a somewhat destabilizing effect on the village "community," which provides the bedrock of India's social, political, and economic system. Because the new hybrid varieties are much more costly and productive, farmers have had to seek credit, markets, and labor beyond the village. In our view, these changes have loosened traditional social and economic ties and increased competition for resources. In some cases, these pressures have led to localized outbreaks of communal or caste violence.

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Unbalanced growth between regions has also increased tensions and fueled support for local political parties. One of the complaints in predominately Sikh Punjab is the perception by many Sikhs that their state's wealth, due in large part to HYV agriculture, was being "exploited" by the federal government. As a result, the rural-based Sikh Akali Dal Party accused New Delhi of not giving Punjab its fair share of state industrial investment and adequate prices for its farm produce.

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Farm Politics

One of the major outgrowths of the Green Revolution has been the advent of the independent farm "union" movement—organizations largely composed of small and medium-sized landholders. As

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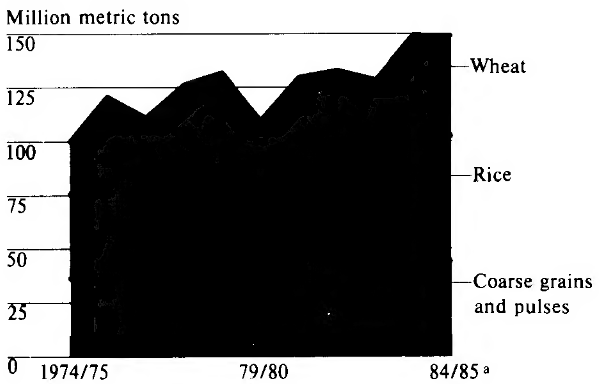
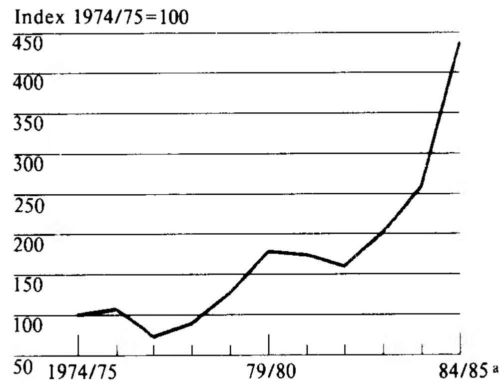
India: Agricultural Indicators

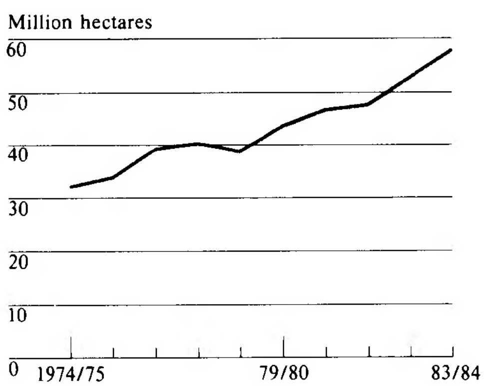
Foodgrain Production *increased . . .*



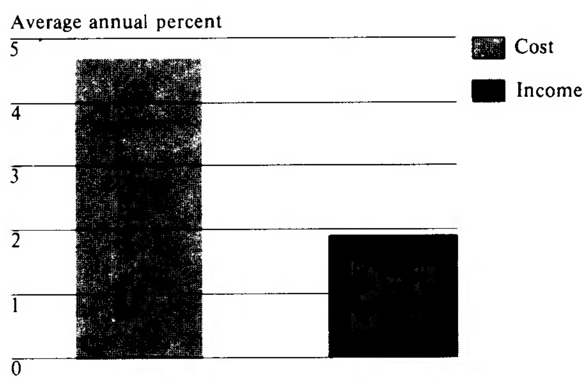
As ***Food and Fertilizer Subsidies*** *have soared.*



Area Under High-Yielding Varieties *has grown . . .*



But rising ***Real Input Costs*** *have slowed* ***Real Farm Income Growth.***[b]



[a] Estimated.
[b] 1974/75-1983/84.

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cultivation costs rose and farm profits narrowed, more farmers in states most affected by the Green Revolution have joined farm "unions" that now exist in eight of 22 states 25X1

In our view, farm unions have been increasingly successful in wresting concessions from both state and national governments. Since 1980 press and US Embassy reporting indicate that union-inspired protests have resulted in higher procurement prices, lower electricity and irrigation rates, and the postponement of overdue loans. Farm group pressure contributed to New Delhi's decision in 1981 to accept a more generous parity method for computing agricultural procurement prices. According to press reports, Rajiv Gandhi has recently conceded to a major farm union demand to restructure the Agricultural Prices Commission by allowing farm representatives to participate, for the first time, in the setting of national procurement prices. 25X1

Outlook

We judge that continued expansion of farm production will be one of the major goals of Gandhi's new administration. Indian planners estimate that agriculture will have to grow at 4 percent per year—near the average of the past five years—to sustain a projected GNP growth rate of 5 percent over the current Five-Year Plan (1985-90). Because crop yields are still relatively low, we judge that more efficient use of improved farm technologies, improvements in rain-fed farming, and favorable weather could boost production near anticipated levels. 25X1

Although New Delhi is likely to stress reducing agricultural subsidies, any sharp cutbacks would jeopardize efforts to increase agricultural growth and provoke protests from politically active farmers. We judge that farmers will use unions, farm cooperatives, and political parties to lobby successfully at the state and national level for higher prices and subsidized credit. We also expect these farm groups to take a more active role in shaping agricultural policy while pressing for reduced imports and increased farm exports. 25X1

The Green Revolution is shifting trade patterns with the United States. Higher foodgrain production has already ended commercial foodgrain imports and, provided there are no major droughts, the prospects for future large US grain exports to India are dim. Progress in oilseed production is likely to be slow, however, and India will continue to be a potential market for US producers for several years. As domestic agriculture develops, market and investment opportunities for US agroindustries such as food processing, pesticide, chemical fertilizers, and farm machinery are also likely to increase. 25X1

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Venezuela: Adjusting to the Depressed Oil Market [redacted]

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Venezuela's economy is stagnating as the oil boom fades and Caracas is responding by retrenching on imports, ambitious development projects, and oil exploration. Austerity is bringing fiscal and current account surpluses, but unemployment and idle capacity are rising. With no rebound likely in the oil markets in 1985, austerity will continue. Fiscal policies are likely to remain tight, and Caracas will again post a current account surplus. Despite some planned stimulation, we believe economic growth will be nil in 1985. A sharp fall in oil prices—while not currently expected—would likely cause an economic plunge. More likely, the economy will continue to limp along and President Lusinchi will be able to deal with domestic discontent. [redacted]

The Oil Controlled Economy

Oil dominates Venezuela's economy, generating 93 percent of export receipts in 1984 and almost 25 percent of total economic activity. The government oil monopoly, Petroleos de Venezuela (PDVSA), controls the oil sector, providing 65 percent of public revenue. [redacted]

The government exercises a strong role in the economy. The oil boom led to a major expansion of the public sector, which now accounts for more than 40 percent of economic activity. The government is using oil revenues to support economic diversification by direct investment in steel and aluminum industries. Moreover, to stem the decline in living standards, Caracas has directed private firms to raise employment and provide additional worker benefits. The current administration has continued to control imports, prices, wages, interest rates, and foreign exchange to buffer the domestic economy from oil price fluctuations. [redacted]

Adjusting to Fading Prosperity

Venezuela faced steady downward pressure on oil revenues since 1980, as world prices fell and OPEC established production quotas. [redacted] 25X1
[redacted] total oil production—including condensates and gas liquids—has slipped from 2.5 million b/d in the late 1970s to 1.9 million b/d in 1984, although the average revenue received for Venezuelan crude has dropped 20 percent to $26.74 per barrel. Oil export revenues declined from a $19 billion peak in 1981 to only $14.8 billion in 1984. 25X1
[redacted] 25X1
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Caracas last year began adjusting domestic spending and investment to the falloff in revenues. To protect the nation's ability to repay debt and to

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Venezuela and OPEC

Venezuela, a charter member of OPEC, typically seeks cooperation and compliance among members. In 1984, however, Caracas sharply criticized OPEC cuts in Venezuela's production quota. [redacted] 25X1
[redacted] *senior administration officials criticized production cheating elsewhere in OPEC and called for noncompliance or withdrawal from the cartel. Nevertheless, the criticism has quieted recently, and we expect Venezuela to remain in OPEC and emphasize production monitoring to minimize cheating and help support prices.* [redacted] 25X1

We expect Venezuela to have further disagreements with OPEC in 1985, however. OPEC has talked about including condensates and gas liquids in production quotas and setting price guidelines on refined products. Caracas, with a large percentage of its exports in products, is unlikely to accept OPEC price controls on these. OPEC could also impose further production cuts in 1985, and serious resistance could arise in Venezuela as revenues and currency reserves decline. [redacted] 25X1

Venezuela: Oil Statistics

Thousand b/d, except where noted

	1983	1984	1985 [a]
Production	1,853	1,856	1,730
Crude	1,763	1,690	1,555
Condensate	33	109	115
Natural gas liquids	57	57	60
Consumption	346	322	345
Exports	1,500	1,517	1,410
Crude	986	1,007	960
Products	514	510	450
Export price *(US $ per barrel)*	25.31	26.74	26.57
Export revenue *(Billion US $)*	13.9	14.8	13.7

[a] Estimated.

[redacted]

Venezuela: Balance of Payments

Billion US $

	1982	1983	1984
Current account	−4.2	4.4	4.4
Trade balance	2.9	8.3	8.7
Exports (f.o.b.)	16.5	14.7	15.9
Imports (f.o.b.)	13.6	6.4	7.2
Services balance	−6.5	−3.7	−4.1
Unilateral transactions (net)	−0.6	−0.2	−0.2
Capital account	3.9	−3.4	−2.2
Private sector (net)	−3.9	−2.7	−0.8
Public sector (net)	7.8	−0.7	−1.4
Errors and omissions	−2.4	−0.3	−0.1
Changes in reserves	**−2.7**	**0.7**	**2.1**

[redacted] 25X1

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prevent inflation, President Lusinchi ordered public spending cut 10 percent, raised domestic oil product prices, maintained strict import controls, and refused labor demands for wage increases. [redacted]

Another Lackluster Performance

Lusinchi's austerity policies led to a decline in real GDP of 2 percent in 1984 and a rise in unemployment to 15 percent, according to the US Embassy. The external accounts were more favorable. With a tight cap on imports, Caracas registered a $4.4 billion current account surplus. Official reserves now total $13.5 billion, and Caracas paid $1.7 billion on debt principal in 1984. [redacted]

Success in cutting public spending and the lack of public investment produced a fiscal surplus equal to 5 percent of GDP. This put downward pressure on Venezuela's economy because the budget surplus—held in sterile Central Bank accounts—is not available for new lending. [redacted]

The sharp cut in oil exploration and development activities underlies the plunge in domestic investment. [redacted] 25X1
excess oil production capacity has allowed PDVSA to reduce oil investment by 35 percent. Most other industries suffer from low demand caused by declining real incomes, and the US Embassy reports that private domestic investment has declined for the sixth year in a row. [redacted] 25X1
[redacted] because of concern over extensive government controls, new foreign direct investment is largely reinvestments forced by Venezuela's profit repatriation laws. [redacted] 25X1

The declining standard of living—per capita income has fallen 20 percent since 1980—is causing labor and middle-class discontent. The US Embassy reports that business leaders are clamoring for wage restraint and relaxation of price controls. The Lusinchi administration promised last September to move toward decontrol of prices, but now is

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retreating in the face of labor demands for wage improvements and protection from inflation. With strong ties to labor, the Lusinchi administration began eying a fiscal stimulus package late in the year to reverse the rising unemployment rate. [redacted]

Current Oil Restraints

Although the world oil market remains weak, Venezuela will be less seriously affected than most other OPEC producers. We estimate that current crude production is 1.6 million b/d—half are heavier types, which the Venezuelans do not consider to be subject to OPEC price guidelines. Currently, PDVSA is selling its heavier crudes with little difficulty. [redacted] prices for heavier crudes are strengthening as world refineries adapt to process these cheaper inputs. As a result, OPEC dropped prices for light crudes by over $1.00 per barrel in February, Venezuela's average export price only declined by 50 cents. Venezuela also is producing more condensates and gas liquids, which are not included in OPEC production quotas. One-third of petroleum exports are refined products, which, while facing weak markets in 1985, are also not price controlled by OPEC. [redacted]

According to US Embassy reports, PDVSA assumes that OPEC quotas will remain in effect through 1985, reducing export volume to 1.4 million b/d compared with 1.5 million b/d in 1984. PDVSA is optimistic that prices will remain about the same as last year. Caracas has drawn up a conservative budget that aims to maintain a fiscal surplus, but in February the government announced a $500 million public works package, equal to 2 percent of GDP, to help reflate the economy in late 1985. [redacted]

Looking Ahead

Despite the fiscal stimulus, we foresee continued recession in 1985 as oil revenues again constrain the economy. We expect oil revenues of $13.7 billion, a drop of 7 percent compared with last year. To protect the payments position, import controls will remain tight, and Venezuela probably will post a $2 billion current account surplus. Nonetheless, Caracas will need to draw down reserves by $2 billion to settle private-sector interest arrears—key to finalizing the multiyear rescheduling agreement—and to continue interest and principal payments on public-sector debt. [redacted]

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With another year of economic stagnation, unemployment will rise to around 18 percent. We believe labor demands for large wage increases will be successfully resisted, and inflation will remain below 15 percent. Business demands for full removal of price controls will also be resisted, but at the expense of reviving investment in 1985. Venezuela will probably restrain imports and control the economy with a heavy hand. Caracas will likely continue to repay both interest and principal on its debt, but it remains a poor candidate for absorbing increased US exports or new investment opportunities. [redacted]

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If oil prices fell to $22 per barrel or OPEC cut Venezuela's quota again by 200,000 b/d, we believe oil revenues would fall to $11-12 billion. Instead of a surplus, we believe the current account would register a $1 billion deficit and reserves would probably drop by $3-4 billion. Venezuela's ability to repay debt and interest could be seriously hurt, jeopardizing the $21 billion public-sector debt rescheduling now nearing final agreement. Moreover, we believe real GDP would drop by 4 percent, causing unemployment to rise to 25 percent. The Lusinchi administration might then be unable to resist severe pressure, from both labor and business, to stimulate the economy [redacted]

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[redacted]

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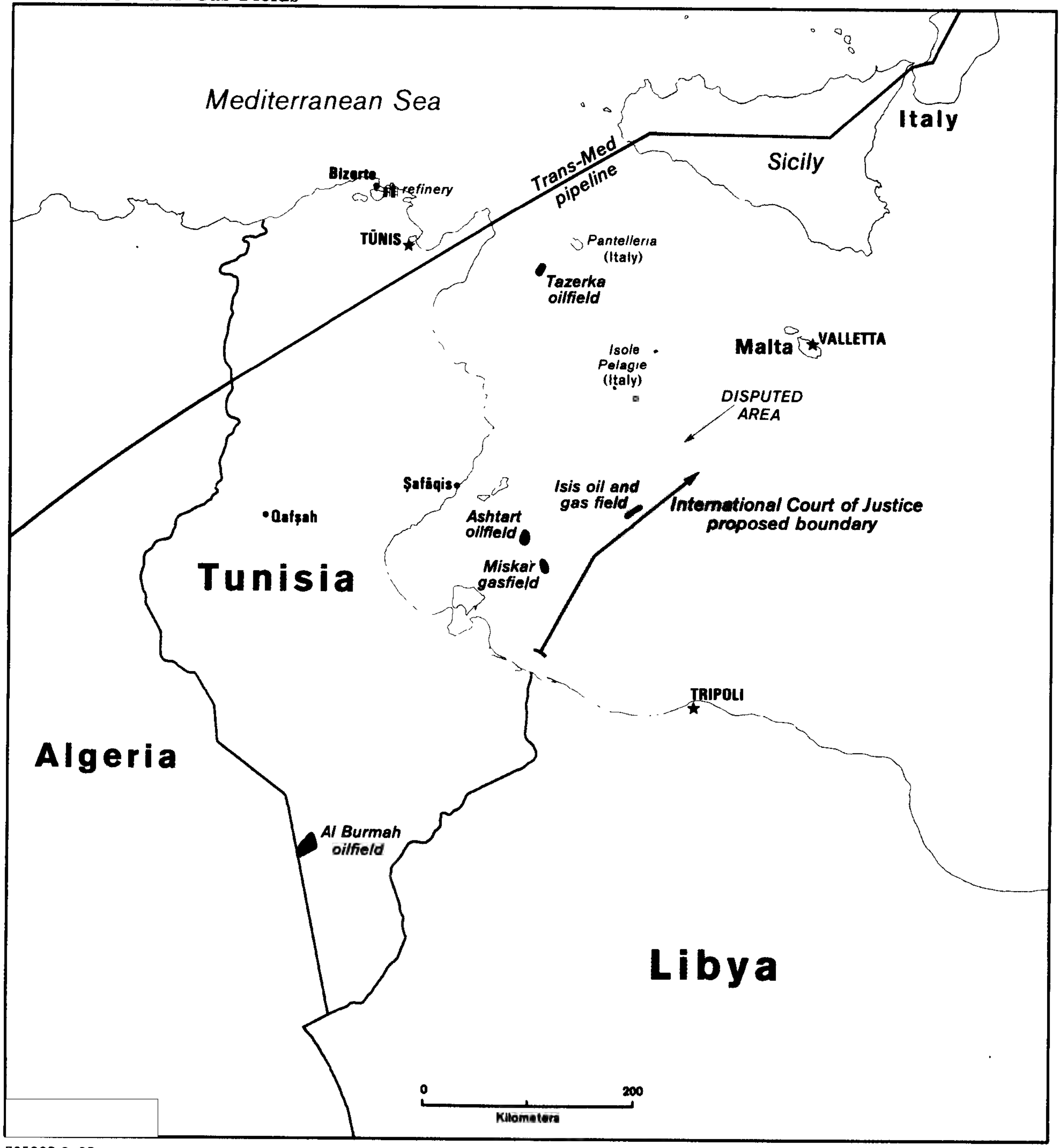
Tunisian Oil and Gas Fields



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Tunisia: Economic Strains and Social Tensions 25X1

The Tunisian Government has been increasingly unable to meet rising expectations created by rapid economic development during the 1970s and one of the highest adult-literacy rates in Africa. Social tensions erupted in nationwide riots in January 1984 following government efforts to reduce burdensome food price supports. Particularly ominous for the government is the growing wealth disparity between regions and social classes and the alienation of Tunisian youth. President Bourguiba's upcoming visit to the United States probably will be used to elicit greater financial aid for Tunisia's ailing economy and security assurances in the event of domestic turmoil or foreign aggression.

The Social Malaise

Tunisia suffers from a growing economic disparity between the prosperous coastal cities and the impoverished interior. Coastal areas have benefited from the development of tourism, commerce, and the oil industry, while the south and the west have suffered from the government's neglect of agriculture. Average income in the south is as much as 40 percent below that of the coastal cities.

This economic imbalance has prompted a growing migration to urban areas. About 55 percent of the population now lives in urban centers compared with only 45 percent in 1970; if unchecked, 75 percent of the population will live in urban centers by the turn of the century with one-half in Tunis. Unskilled, rural migrants often remain unemployed or restricted to menial labor. Migrants played a major role in last year's riots, and they remain a pool of idle, disillusioned poor who could again vent their frustrations in violence.

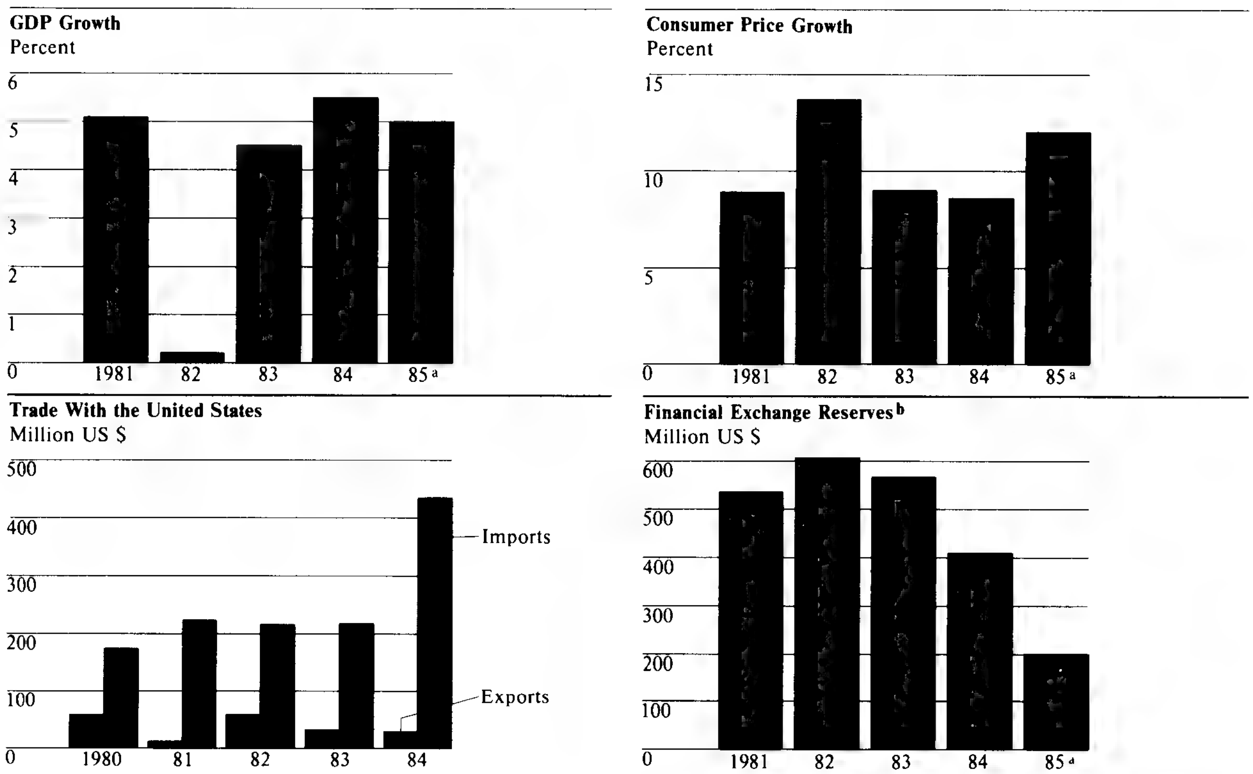
Political and generational differences exacerbate regional economic disparities. President Bourguiba's secular, pro-Western government is dominated by members of the social elite from the French-speaking coastal cities and has little popularity in the south. About 70 percent of the population is under 26, and this group is hardest hit by unemployment. Even college graduates often cannot find employment commensurate with their education. Few of the young join the ruling Destourian Party, but a growing number are attracted to conservative Islamic groups. 25X1

The Economic Crunch

The economy began to slow in the late 1970s when Tunisia's main sources of foreign exchange earnings—petroleum, tourism, phosphates, and worker remittances—languished as a result of the international recession. Real GDP growth has averaged 4 percent annually since 1979—two-thirds of the level of the previous four years—and has barely been sufficient to absorb the 3.8-percent annual increase in the nation's labor force. Reduced demand for Tunisian labor in Western Europe and wealthy Arab states has helped push unemployment to 20 percent in urban areas, according to official Tunisian estimates. We believe, however, that the actual level of unemployment is closer to 30 percent. 25X1 25X1 25X1

Stagnating foreign exchange earnings have seriously weakened Tunisia's international payments position. The current account deficit last year of $1 billion was up 65 percent over the 1983 level because of the soft oil market, a poor harvest, and a sharp rise in domestic consumption. Tunis has financed the steadily rising current account deficits with overseas loans and now has an external debt of about $4.6 billion—55 percent of GDP. Debt service payments consume about one-fourth of receipts from exports of goods and services. Foreign exchange reserves of $225 million cover only one month of imports. 25X1 25X1

Tunisia: Economic Indicators, 1980-85



[a] Projected.
[b] End of period, excluding gold.

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Prime Minister Mzali pushed through a barebones budget this year to halt the escalating government deficit and stem foreign borrowing needs. He has announced plans to tighten the collection of taxes and tariffs and reduce government food subsidies. These measures, however, will greatly complicate government efforts to keep peace with organized labor. Labor problems this spring have been subdued because of ongoing wage negotiations with the government. Union leadership may not be able to maintain the calm, however, if Tunis holds the line on wages and goes ahead with food price increases.

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Agriculture remains a bottleneck in the economy. Government neglect and pricing policies favoring imported grain over domestic production have led to poor performance in this sector. Agriculture employs one-third of the population but accounts for only 15 percent of GDP. Food imports already meet about 50 percent of demand. Agricultural output probably will lag population growth during the next several years, adding to the foreign payments deficit.

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The Vital Oil Sector

Petroleum is a mainstay of the economy, accounting for 53 percent of export earnings, about 21 percent of government revenues, and 16 percent of GDP in 1984. We estimate that production is currently averaging about 115,000 b/d. Declining reservoir pressures and limited success with secondary recovery techniques in the main oilfields—Al Burmah and Ashtart—will cause production from these fields to continue to decline. Production from oil and gas fields still under development—Tazerka, Miskar, and Isis fields—should allow production to remain near current levels for several years, but the US Embassy estimates that the rapid growth in domestic consumption will cut into net oil export volume. Tunisia could become a net oil importer by the end of this decade, according to industry estimates.

The boundary dispute and political tensions between Tunisia and Libya have been major obstacles to development of promising offshore fields. Tunis has yet to accept the International Court of Justice ruling delimiting the offshore boundary between these two states. A second hearing on this dispute is in progress.

The Political Shell Game

Bourguiba's advanced age—82—and chronic health problems have dulled his political acumen causing him to spend less time directing public policy. His continuing grasp on power, however, frustrates efforts to ameliorate Tunisia's pressing social and economic problems. The government is increasingly being viewed by the growing number of educated youth and unemployed as a tool of the elite that is dangerously out of touch with the needs of the population.

Uncertainty over Bourguiba's longevity contributes to government infighting in anticipation of the post-Bourguiba period. Mzali's efforts to ensure his position as Bourguiba's successor have eroded his popularity and respect for the regime. Mzali's lack of popularity complicates his prospects for consolidating power after Bourguiba leaves office. 25X1

Outlook

We believe that Tunisia's financial position will continue to remain weak for the rest of the decade. Oil revenues will decline as export volumes fall—more so if energy prices decline. Government efforts to boost exports of Tunisian textiles and agricultural products will be hampered by West European quotas. With aid prospects limited, additional international borrowing will be necessary to meet the expectations of the burgeoning population and to finance military modernization and economic development goals. The gap between consumption and production of foodstuffs will increase unless politically sensitive food subsidies are trimmed and price controls are eliminated. This, 25X1
however, would again push inflation to double-digit levels and risk consumer unrest. 25X1

Pressure from organized labor to maintain consumer subsidies will frustrate government efforts to keep spending in line with revenue. Radical elements in Tunisian society increasingly will try to capitalize on the declining standard of living and 25X1
periodic labor unrest to organize and gain concessions from the regime. The government will be more pressed than in January 1984 to put down widespread unrest when it recurs and will increasingly have to rely on repression to remain in power. Bourguiba's death almost certainly will aggravate the situation as the military's support of Mzali is less certain, in our opinion. 25X1

Implications for the United States

Bourguiba sees his visit to the United States as a very personal one, highlighting the longstanding close ties Tunisia has had with Washington. He 25X1
will seek Washington's reassurances of protection

Tunisia: Current Account Balance

Million US $

	1980	1981	1982	1983	1984	1985 [a]
Current account balance	**−443**	**−489**	**−691**	**−634**	**−1,049**	**−710**
Trade balance	−1,078	−1,070	−1,292	−1,182	−1,550	−1,180
Exports (f.o.b.)	1,804	2,110	1,625	1,574	1,450	1,390
Petroleum	1,345	1,308	910	835	770	730
Imports (f.o.b.)	2,882	3,180	2,917	2,756	3,000	2,570
Foodstuffs	390	428	357	425	395	300
Services (net)	620	563	560	531	486	450
Of which:						
Receipts from tourism	640	598	575	553	540	490
Worker remittances	320	360	372	345	320	300
Interest on external debt	−184	−210	−204	−191	−205	−210
Private transfers (net)	15	18	41	17	15	20

[a] Projected.

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in the event of domestic turmoil or external aggression. He may also pursue additional financial assistance—including military debt relief—to help ease mounting social and security pressures as a measure of US appreciation for Tunisia's consistent support for US policies. 25X1

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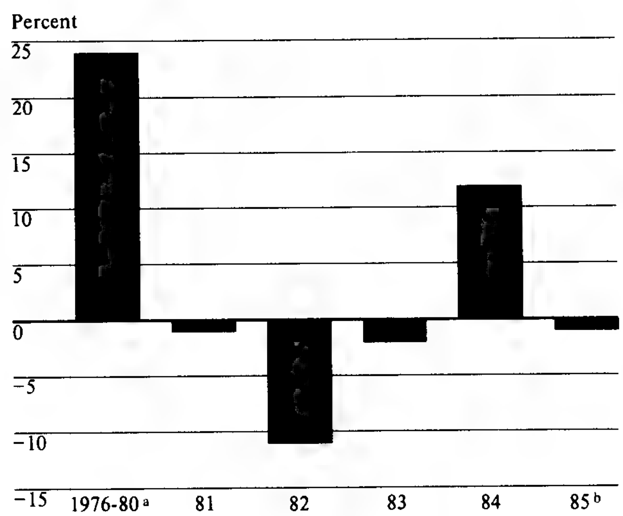
Key Debtor LDCs: Exports Decline This Year [1] 25X1

We believe that exports for 12 key LDC debtors will decline this year following the sharp rebound in 1984.[2] Among nonoil exporters, only Chile is likely to record faster export growth this year; Bolivia and Brazil face export declines. Colombia and Indonesia should do the best among oil exporters in the group. Slowing export growth, combined with higher debt service payments, could force these governments to squeeze imports, hurting chances for continuing economic recovery in these 12 countries over the second half of this year. Reduced export growth could also put strains on their debt servicing capacity. 25X1

Contributing Factors

The projected slowdown in OECD economic growth likely will trim OECD import demand. On the basis of OECD projections, real GNP in the industrialized countries will rise about 3 percent in 1985, only two-thirds as fast as last year. In addition, continued slack oil sales will hold down overall export gains for the oil exporters. Increasing developing country protectionism and loss of LDC export incentives because of budget cuts also will limit export prospects of several key debtors, especially Brazil. Real exchange rates for the key debtors are expected to show little change, on average—compared with a 3-percent appreciation in 1984 that cut into their competitiveness. 25X1

Key Debtor LDCs: Export Growth, 1976-85



a Average annual.
b Projected.

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Smaller Gains for Nonoil Exporters

For nonoil exporters as a group, we estimate export growth will average about 1 percent compared with last year's 16-percent increase. Only Chile is expected to show faster gains, and Bolivia and Brazil face the possibility of an export drop. 25X1

Among individual countries:

- ***Argentine*** grain exports are likely to suffer from stiff competition and weak prices; beef exports face competition from subsidized EC sales. Overall export growth in 1985 is likely to be only one-fourth of last year's pace.

[1] This article is based on a forthcoming research paper. 25X1
[2] The group includes Argentina, Bolivia, Brazil, Chile, Colombia, Indonesia, Malaysia, Mexico, Nigeria, Peru, the Philippines, and Venezuela 25X1

- ***Brazil***'s export performance probably will be far less robust than last year's. Exports of manufactures, such as footware and steel, are likely to decline, and sales of commodities could stagnate. Increased protectionism and reduced export incentives, because of budgetary constraints and GATT commitments, could also dampen exports.

- ***Chile***'s copper export earnings should increase this year as production rises 2 to 6 percent and prices recover. In addition, exports of iron ore should also rise.

- ***The Philippines*** should benefit from recovery in the coconut oil and timber markets. 25X1

Slower Export Growth for Oil Exporters

Export earnings for the oil-exporting key debtors are likely to drop 1 percent in 1985, compared with a 10-percent gain last year. Overproduction and weak demand continue to depress oil prices. Growth in nonoil exports is also likely to slow from last year's pace. Colombia, Indonesia, Malaysia, and Nigeria should record modest to large export gains, and Mexico, Peru, and Venezuela probably will suffer export declines:

- ***Colombia***'s export prospects should be bolstered by higher coal sales, and coffee exports should recover after a decline last year because of bad weather.

- ***Indonesia*** and ***Malaysia*** face slowdowns in exports of rubber, timber, and palm oil. Oil earnings are expected to show little change.

- The US economy's slowdown and the overvalued peso likely will lead to a drop in ***Mexican*** manufactures exports. Oil export earnings are also likely to decline.

- Because of a desperate need for foreign exchange, ***Nigeria*** is likely to maintain high oil production, but soft prices will cut the growth in export earnings.

Key Debtor LDC Exports, 1983-85

	Billion US $			Percent Change	
	1983	1984	1985 [a]	1984	1985 [a]
Total	**122.7**	**137.2**	**136.3**	**12**	**−1**
Argentina	7.8	8.7	9.0	12	3
Bolivia	0.8	0.7	0.7	−12	−3
Brazil	21.9	26.9	26.5	23	−1
Chile	3.8	3.7	4.0	−3	8
Colombia	3.0	3.0	3.2	−2	8
Indonesia	16.0	17.1	17.8	7	4
Malaysia	13.8	16.3	16.7	18	2
Mexico	21.4	24.1	22.5	13	−7
Nigeria	11.6	12.2	12.4	5	2
Peru	3.0	3.2	3.1	7	−3
Philippines	4.9	5.4	5.6	10	4
Venezuela	14.7	15.9	14.8	8	−11

[a] Projected.

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- ***Peru***'s export earnings this year could drop by 3 percent because of weak prices for traditional exports and lack of export financing. 25X1

Implications

Declines in export growth could exacerbate debt servicing difficulties for most of these countries. Argentina's debt situation remains bleak: it continues negotiating with the IMF, and bank creditors have not yet committed the $4.2 billion that they agreed in principle to provide. Similarly, Brazil continues its IMF negotiations, and concern about its foreign exchange earnings capacity supports speculation that Brazil will need new money by late 1985. Peru and Bolivia remain in grave debt situations, and a fall in export growth will make their

condition worse. Colombia, Mexico, and Venezuela are doing relatively better with external debt arrangements, and the decline in export growth for Mexico and Venezuela will not pressure them greatly. The Philippines recently signed a financial package with creditors that includes trade credits, so export growth declines will not have as much impact. Overall, the expected export slowdown likely will constrain import growth and dim prospects for continuing economic recovery in the second half of this year. Brazil's trade surplus could decline by as much as $2 billion from last year's level. Chile and Colombia will have little room for import gains, because increased exports could be offset by higher debt service payments. Export declines imply continued austerity in Bolivia and Peru. Slowing export growth could imperil Mexico's fledgling economic recovery and dash Nigerian hopes for renewed real GNP growth. In addition, reduced export gains probably will slow the growth of real income in Indonesia and Malaysia. 25X1

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Briefs

Energy

Australian-Japanese Gas Sales Agreement

Representatives of eight Japanese utilities have initialed a contract with six Australian suppliers to import 6 million metric tons of liquefied natural gas (LNG) annually for 19 years beginning in 1989. At current prices, the gas would be worth about $1.6 billion per year. If government approvals can be obtained and financial terms arranged by the end of July, construction of liquefaction and loading facilities could begin in Australia by the end of the year. Japan signed a letter of intent in 1981, but financial difficulties among the Australian backers, together with downward revisions in Japanese energy demand, delayed the initial 1986 start-up date. Australian LNG is expected to cover about 15 percent of Japanese LNG demand after 1990. Tokyo now has sufficient supplies tentatively lined up to meet about three-fourths of its natural gas requirements through 2000. 25X1

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European Coal Imports Rise in 1984

Coal imports by the European Community in 1984 rose 30 percent over year-earlier levels to a record 80 million metric tons, partly offsetting the 72-million-ton drop in EC coal production. The UK coal strike accounted for 67 million tons of the decline in EC output, and led to UK coal imports of nearly 9 million tons, more than twice the amount imported in 1983. Fuel oil was widely substituted for coal during the UK strike. Other EC coal consumers increased coal imports by one-fourth, as a result of the greater use of coal for power generation. Australian shipments to EC buyers nearly doubled to more than 15 million tons, while imports from South Africa rose 26 percent to 20 million tons. Imports from Poland rose 50 percent to 15 million tons. Of the major suppliers, only the United States—whose exports remained flat at 24 million tons—failed to benefit. 25X1

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Aramco Encouraging Early Retirement

Aramco is trying to cut its payroll by increasing retirement benefits for Saudi employees who retire early. The company's manpower has stayed about the same in recent years even though liftings have declined by two-thirds. Under Aramco's new retirement formula, the "typical" retirement benefit will be increased by 7 percent, according to the US consulate in Dhahran. If this does not induce a sufficient number of Saudis to retire voluntarily, Aramco intends to force 500 to 600 older employees to take early retirement. Saudi employees are currently eligible for full retirement at 60—counted in shorter Saudi lunar years—and may retire as early as 50 with 60 percent of full benefits. 25X1

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International Finance

West German Bank Exposure to Major Debtor Countries

West German banks in general have kept their international lending within conservative limits, according to Bundesbank data—which for the first time includes activities of foreign subsidiaries. These subsidiaries—about half are in Luxemburg—accounted for almost one-third of total West German bank international lending. At the end of 1984, West German banks held $35 billion or 8.7 percent of total Western bank exposure to the 25 largest debtor nations. West German banks, however, account for a large share of Western bank lending to Turkey (33.1 percent), Israel (26.2 percent), Poland (25.6 percent), and the USSR (19.5 percent). 25X1 25X1

IMF Relaxes Philippine Austerity

Growing concern over the recent appreciation of the Philippine peso led the IMF last week—at Manila's request—to relax the money supply growth target set late last year. The peso appreciated 6 percent against the US dollar and nearly 15 percent on a trade-weighted basis since last November, causing a $120 million slippage in exports according to our estimate. Manila will now be permitted to expand reserve money, which determines the total credit available in the economy, by 15 percent this year rather than the original ceiling of 11 percent. The new limit allows the Central Bank—the only major buyer of foreign exchange over the past year—to accelerate foreign exchange purchases. In a related move, Manila last week raised the limit on foreign exchange assets commercial banks may hold. We judge these moves will weaken the peso, halting the slide in the country's export performance but threatening to rekindle inflation, currently running at only a 5 percent annual rate. 25X1 25X1

Global and Regional Developments

OECD Call for Economic Stimulus

The recent OECD Secretariat's *Economic Outlook* stresses the need for more stimulative economic policies in Western Europe to stem unemployment, now averaging 10 percent and rising. The report argues that recent declines in the US dollar and US interest rates enable West European governments to take immediate action to lower interest rates further and boost growth above the 2.3 percent now projected through 1986. Moreover, the Secretariat also calls for "appropriately designed" tax cuts to revive domestic damand and investment. The Secretariat bases its unusually direct warning on its forecast of less than 3-percent US GNP growth through 1986 that would mean a slowing of US demand for West European products. US imports have accounted for almost half of West European GNP growth since the recovery began. If their economies fail to perk up soon, the West European leaders—particularly those in France, West Germany, and the United Kingdom facing elections beginning in 1986—may have to consider tax cuts or other stimulus. 25X1 25X1

GATT Debate on Nicaraguan Embargo

Nicaragua's attempt to protest the US trade embargo in GATT has met with little success. During the GATT Council debate last week, representatives of most of the 34 countries participating criticized the embargo but urged a bilateral solution. The EC, Japan, Canada, and Australia supported the US legal position that GATT is not the proper forum for this issue. Some Latin American and Asian countries appealed to the United States to end the embargo, but all African and ASEAN countries were silent. Only Cuba fully supported Nicaragua's proposal to condemn US actions and initiate GATT's dispute settlement procedures. Although Nicaragua has succeeded in drawing attention to, and gaining some support for, its position, the lack of immediate action by the GATT Council, means that debate in this forum is likely to be deferred. 25X1

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EC Development Aid for Nicaragua

The European Community will give Nicaragua $5.1 million in development assistance to improve facilities for storing and exporting food products. EC Commissioner Cheysson and Nicaraguan Vice President Ramirez signed the agreement last week in Brussels at the end of Ramirez's four-nation European tour. Both officials used the occasion to criticize the US embargo—and Cheysson contended that the sanctions conflicted with the EC's economic philosophy. According to Cheysson, Nicaragua has received more than $25 million in EC financial and technical assistance since 1979. The funds for the new projects almost certainly were not triggered by the US embargo and do not represent a new aid commitment. The funds were approved last year as part of the Community's ongoing aid program for developing countries. Cheysson's comments reflect his personal views and do not constitute official EC policy. Many EC members, however, strongly oppose the US trade action and are likely to make marginal increases in imports of Nicaraguan foodstuffs. 25X1

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Tropical Timber Agreement

The International Tropical Timber Agreement (ITTA) entered into force on 1 April 1985 following eight years of negotiations as part of UNCTAD's Integrated Commodities Program. Unlike agreements on coffee, sugar, tin, and rubber, the pact contains no provisions for controlling market supplies or stabilizing prices. Its objective is to provide a framework for cooperation between producing and consuming countries to promote expansion and diversification of trade in tropical timber. Only coffee and sugar among the nonoil commodities generate greater export earnings for LDCs. The ITTA is also the first pact to link trade with national policies aimed at conservation of tropical forest resources. All of the major producers have signed the accord, including Indonesia, Brazil, and Malaysia, which together account for more than two-thirds of the estimated $7 billion a year global trade in tropical timber. Major consumer signatories include Japan, the EC, and the United States, which together account for about 90 percent of annual global imports of these products. The first meeting is scheduled for 17-28 June in Geneva. 25X1

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National Developments

Developed Countries

New Canadian Grain Export Policy

Ottawa's hardline stance toward the US export bonuses program does not represent a basic change in its recent grain export policy. The "new" policy, administered by the Canadian Wheat Board (CWB), consists of aggressive price cuts, extensive credits, bonus giveaways of hard-to-export winter wheat, and $250 million in subsidies to be hidden in contracts—all devices that have been used in the past six months. Recent credit examples include shipments to Brazil and the new five-year pact with Egypt. Aggressive pricing has been used in sales of durum wheat to Japan and in a hidden price concession—supplying a more expensive wheat variety—in a contract with Taiwan. In addition, the CWB is attempting to include wheat in a countertrade negotiation with Nigeria. Canada is currently diversifying into less expensive, lower quality wheat for which demand is growing faster, in order to achieve a 25-percent increase in grain exports by 1990. Target areas include the Middle East, North Africa, and the Pacific Basin.

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West German Plans for Fiscal Stimulus

Bonn apparently has decided on some form of fiscal stimulation in light of the setback suffered last month by Chancellor Kohl's Christian Democrats in a key state election. Much of the blame for the defeat has been placed on the lack of progress on unemployment. The magnitude and form of the measures, currently under intense debate, will be announced at the end of June. The Free Democrats and the Christian Social Union—junior partners in the coalition—are calling for compressing the 1986-88 tax cut into a single step in 1986. Other proposals center on spurs to investment in construction and for environmental protection. We expect that whatever is enacted will be modest enough to allow the government to claim that it is not abandoning its longstanding policy of budget deficit reduction and primary reliance on private-sector initiatives.

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Italian Wage Indexing Referendum

The Communists, shaken by losses in recent local elections, are beginning to worry that their referendum on wage indexing will be defeated on 9 June, seriously eroding their claims to speak for the working man. Last year Prime Minister Craxi pushed through a cut in the quarterly inflation adjustment, roughly equal to 4 percent and the referendum seeks to rescind that cut. The governing parties, management, and moderate labor unions oppose the referendum, because it might trigger a new round of inflation. Even in the Communist-dominated trade union, most non-Communist members oppose it. Many political leaders also worry that the referendum may set a dangerous precedent for economic decision making. Some Communist leaders would prefer to drop the initiative—launched by former party leader Berlinguer about a year ago—despite current indications that it would pass. Last week, however, representatives of government, management, and unions apparently gave up attempts to negotiate a settlement that would have averted the

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referendum. Reducing wage indexing is widely considered one of the most significant accomplishments of Craxi's two-year administration, and Craxi has said that he will resign if the cut is restored. [redacted] 25X1

British Industry Seeks Role in SDI Research

[redacted]

British industry and research organizations are reportedly actively negotiating contracts to participate in SDI research, even before London formally replies to Washington's invitation. According to press reports, Logica, a leading computer company, hopes to win a $200,000 software contract probably for directing laser guns. At the same time, Edinburgh's Heriot-Watt University expects to receive a grant of $150,000 to work with a US company to produce prototypes of optical computing devices. Industry observers believe the British could also make major contributions in the fields of battle management and conventional missiles. Most firms would prefer to sign direct contracts with the Pentagon, rather than subcontracting for US companies. It appears likely that London will eventually decide in favor of the US proposal, primarily to enhance Britain's technological development. In any case, Prime Minister Thatcher would probably encourage private firms to use their own resources to participate. [redacted] 25X1

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French Arms Sales in 1984

[redacted]

For the French arms export program, 1984 was an excellent year. Despite some controversy over the total, we believe a figure of about $6.9 billion is accurate. The 1984 sales total, however, did not match France's record achievements in 1980 or 1982 ($8.2 billion and $7.5 billion, respectively). This impressive performance may fade over the next few years; over half the 1984 total sales came from one deal—an air defense system for Saudi Arabia. This level of sales in a tight arms market, however, is indicative of France's aggressiveness and skill as an arms dealer. We expect stiff competition for future US sales efforts, especially in the aerospace markets. [redacted] 25X1

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Spanish Labor Reform

[redacted]

Government, union, and business leaders will meet this month to discuss modifying Spanish dismissal regulations to conform with EC practices. Although government officials are convinced that rigid labor laws are a serious impediment to lowering the 22-percent unemployment rate, Madrid had to defer action last year to obtain a wage agreement. Business leaders particularly want the elimination of a government commission that must approve dismissals and that usually grants even higher severance payments than required by law. This move is opposed by the Socialist UGT trade union, which is already angered by plans to cut pension benefits and fears that labor flexibility will translate into job losses. Abolishment of the commission, however, probably would have little impact because the continuing difficulty and expense in dismissing workers—severance can be as high as three and a half years' salary—will continue to discourage hiring. [redacted] 25X1

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Less Developed Countries

Mexican-Nicaraguan Economic Cooperation

[redacted]

Mexico's public pledge last week to strengthen economic ties to Nicaragua probably does not portend a return to significant levels of assistance and will not reverse the Sandinistas' dependence on Soviet oil. Mexico City has agreed to supply Managua with 320,000 barrels of oil—about a 25-day supply—under terms of the existing Mexican-Venezuelan agreement. Mexico also expressed willingness to provide an additional 410,000 barrels under conditions yet to be negotiated. Meanwhile, representatives of the two countries are meeting to renegotiate Nicaragua's $600 million debt to Mexico—about $500 million is for oil. Mexican officials have indicated that a joint commission is preparing an export program that could enable Managua to reduce the debt. Nicaragua's deepening financial crisis and the limited potential of the new export program probably will prevent Managua from reducing its debt to Mexico in the near term. Mexico has little need for most of Nicaragua's major exports. Mexico City's actions, coming on the eve of President de la Madrid's visit to five West European countries, may be designed to demonstrate that Mexico is not abandoning Managua or bowing to US pressures. [redacted]

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Brazilian Military Aircraft Sale

[redacted]

Brazil won the competition to sell a new trainer aircraft to Britain's RAF, beating out its main rival, the Swiss Pilatus PC-9, and other competitors from the United Kingdom and Australia. Britain ordered 130 Tucanos worth about $130 million, with an option for 15 more. Brazil won the sale by offering the lowest price, including a UK-produced engine and, most important, licensing assembly of the aircraft in economically depressed Belfast. The Swiss are upset over the sale but could not match the concessionary terms offered by Brazil. This is the third time the Tucano has beaten the Pilatus in a head-to-head competition (Egypt and Honduras were the others), and the RAF sale is expected to open up other sales. [redacted]

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Chile's Export Diversification

[redacted]

Chile is seeking to push forest products—now less than 10 percent of total exports—ahead of minerals and fishery products as the country's primary export earner. According to government plans, forest products exports that totaled $385 million last year will be raised to the $2 billion level by the mid-1990s. Santiago has begun aggressively marketing softwood logs, lumber, and pulp in Latin America, the Far East, and Western Europe. These products compete directly with US forest products. For Chile to succeed, $2 billion in new investments for infrastructure improvements will be required with much of the funding from foreign borrowing. Santiago will have to achieve sufficient political stability to provide a favorable climate for domestic and foreign investment. [redacted]

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Ethiopian Coffee Export Problems

Transportation problems resulting from the diversion of trucks to famine relief activities probably will hold Ethiopia's coffee exports—which usually account for over three-fifths of export earnings—below its International Coffee Organization (ICO) quota this year. Other factors contributing to the shortfall include a late harvest caused by drought in the southern regions, a shortage of pickers, and smuggling. Shipments for the first half of the October/September coffee year were 50 percent below the same period last year. Although Addis Ababa has stated it plans to fill the ICO quota, we believe that trucks will continue to be diverted to food distribution and the government's resettlement program. As a result, Ethiopia's already serious foreign exchange shortage would worsen, forcing Addis Ababa to cut non-food-aid imports further. 25X1

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Troubled Comoran Economy

The Comoran economy, beset by a worsening trade position, burgeoning debt, and longstanding structural deficiencies is deteriorating. Real growth rates during 1981-84 declined from 7.4 percent to 3.3 percent as major construction projects—financed by foreign aid—were completed and growth in the dominant agricultural sector lagged. At the same time, depressed world prices for copra and spices—which account for 99 percent of export earnings—have contributed to burdensome current account deficits. The government has relied on concessional loans and some supplier's credits to close the gap, and external debt equaled 116 percent of GDP in 1984, compared with 38 percent in 1980. Unexpectedly low levels of grant aid and the government's unwillingness to cut spending have hit the budget; total government outlays are now five times domestic revenues and the budget deficit accounts for 18 percent of GDP. A 3-percent population growth rate, primitive farming techniques, lack of natural resources, and insufficient infrastructure will keep the Comoros dependent on foreign largess for the near term. 25X1

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Sri Lankan Insurgency Hurts Foreign Investment

The Tamil insurgency and capricious government economic policies are taking a toll on Sri Lanka's efforts to woo foreign investors. In 1978 the Jayewardene regime began a program of economic liberalization that initially attracted foreign investment and helped diversify its plantation-based export economy. Over the past two years, however, foreign investment and joint-venture approvals have declined by 25 and 45 percent, respectively. Recently, a major US electronics firm decided to pull out of Sri Lanka in breach of contract, reportedly in response to the worsening security situation. According to the US Embassy, the government's control of market access and production quotas have added to a deteriorating business climate. 25X1

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Indonesia's Aid Donors' Meeting

Foreign aid donors met in The Hague this week to review Indonesia's economic performance and to make this year's aid pledges. The World Bank's latest report praises Jakarta's austerity program for avoiding a foreign debt crisis and cutting the current account deficit from 8.4 percent of GDP to 2.4 percent in fiscal year 1984/85. Nonetheless, the Bank estimates that Jakarta will need about $5.2 billion in foreign borrowing annually in the medium term. Only about half the amount will be supplied by commercial sources, requiring aid contributions totaling about $2.5 billion annually in each of the next three years. The donors have indicated a willingness to adhere closely to the Bank's recommendations but will continue to watch Jakarta's progress on followup reforms to improve the economy's efficiency.

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South Korean Economy Slows

Real GNP growth slowed to 4 percent in the first quarter compared with first quarter 1984—following 7.5-percent growth for full year 1984—due largely to a decline in exports. The 8-percent fall in foreign sales in January-March was broad based, reflecting weaker global demand and increased protectionism abroad. Several private forecasters are now projecting 5.0- to 5.5-percent growth for the year, compared with the government's 7.5-percent target. Seoul, which has maintained a tight monetary and fiscal stance to drive inflation below 3 percent, may ease its austere policies to stimulate domestic demand. The Chun government will proceed cautiously, however, because of foreign payments concerns: the current account deficit in the first quarter exceeded the government's $500 million target for all of 1985.

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Brunei Closes Door on Chinese Labor

The Brunei Government announced last week that, beginning next year, it will no longer renew work permits and employment licenses for expatriate Hong Kong and Taiwanese residents. This is the latest in a series of moves against the large Chinese minority, which dominates the country's private sector. Following independence last year, the government imposed strict citizenship requirements that effectively exclude nearly 90 percent of the country's 60,000 Chinese. Without citizenship their access to education is limited and they are denied government employment—which constitutes nearly half of total employment in Brunei. These discriminatory policies have resulted in a steady emigration of Chinese managerial and technical personnel to Singapore and Canada over the last year that, if it continues, will impair the functioning of the country's vital oil and natural gas industries.

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Communist

Romanian-Soviet: Energy Cooperation

Soviet trade officials in Bucharest told US Embassy officers that in 1986-90 the Romanians are to provide equipment and about 2,000 workers for a gasfield project in Turkmeniya, contribute some financing and equipment for the Yamburg gas pipeline, and construct the 183-kilometer portion in Romania of a Soviet gas pipeline to Greece and Turkey. Romania also is to provide equipment and labor to help the Soviets explore for oil and gas in the

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Caspian Sea and Siberia; the Soviets are already laying a pipeline to Romanian offshore deposits in the Black Sea. The Soviets will pay for the expanded Romanian cooperation by providing oil, gas, and other raw materials. The Soviet officials, however, expressed skepticism that Romania can meet its commitments. [redacted] 25X1

President Ceausescu has been pushing Moscow for more cooperation on energy and increased bilateral trade. The Soviets have given a small concession by shifting the oil trade from a barter to a clearing account basis, thus nominally increasing the planned trade level. Much of Romania's best equipment, which was to have been bartered for oil, however, is now included under the clearing account. In addition, Bucharest has been reluctant to provide labor to the USSR; both countries have shortages of skilled labor. Although overall trade is likely to increase, growth will probably fall short of plans, given Romania's economic difficulties and ambitious targets for exports to the West. Bucharest was only able to provide the Soviets with enough hard goods last year to obtain about half the oil the Soviets had agreed to provide. [redacted] 25X1

Poland's Economic Reform Conference

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A party meeting last week endorsed major changes in the economic reform program that would increase the role of the central government. The decision is a retreat from the 1982 reforms that allowed firms more responsibility in areas ranging from wages to production. At the conference Deputy Premier Messner said that the government would not return to strict centralized management, but would maintain and even broaden the state's role in planning and implementing economic strategy. Premier Jaruzelski paid lipservice to reform—most likely to impress Western creditors and the IMF—but endorsed Messner's statements and compared Polish reform to policy changes in other socialist countries, especially the USSR. Other speakers confirmed rumors that reform opponents had gained strength in the past year, because of poor performance by some sectors experimenting with reform and the growing belief that economic recovery demands discipline, not decentralization. Prospects for reform—even before the conference—were dim largely because of the regime's reluctance to take politically difficult steps such as linking wage increases to productivity gains. Moreover, officials are concerned about losing power, and managers are hesitant to take on increased responsibility. [redacted]

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Sino Soviet Long-Term Trade Agreement

A large Soviet trade delegation reportedly arrived in Beijing in mid-May to begin final negotiations on a trade agreement for 1986-90. [redacted] the formal signing is to take place during Vice Premier Yao Yilin's visit to Moscow in July. The agreement reportedly will call for total bilateral trade of some $20 billion over the period, reaching $6 billion in 1990. After languishing during most of the 1960s and 1970s, trade increased from $250 million in 1981 to more than $1 billion last year. The Soviet official stated, however, that these figures are probably optimistic, because each side will try to minimize bartering commodities that could be

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sold for hard currency. He considers total trade turnover of $16 billion a more realistic figure. An unwillingness to barter commodities that could be sold for hard currency is not the only factor that will limit trade growth. A large portion of the total depends on delivery by the Soviets of large amounts of machinery and equipment called for in 18 major Chinese development projects. [redacted] 25X1

Sino-Japanese Friction Over Trade and Technology Transfer

[redacted]

China's complaints about its growing trade imbalance with Japan—$1.4 billion in first quarter 1985 compared with $2.2 billion for all of 1984—may be designed to press Tokyo to increase imports of Chinese goods and transfer production technology. Beijing has stepped up its charges that Japanese firms are unwilling to invest in and to transfer production technology to China and has linked future imports to technology transfer. Earlier this year, the leadership ordered a slowdown in imports from Japan and the United States in favor of goods from Western Europe—particularly France and West Germany. A more long-term bilateral concern is technology transfer. China's State Council last week issued new regulations aimed at stepping up technology imports, and Beijing has exempted purchases of advanced technology from recent measures to curtail imports by provincial authorities. Moreover, Beijing seems willing to overlook West Germany's nearly $300 million trade surplus with China because of Bonn's willingness to transfer technology. [redacted] 25X1

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China and Japan To Initial Nuclear Agreement

[redacted]

[redacted] 25X1

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China's Acrylic Fiber Plans

[redacted]

[redacted] China's textile industry for the next five years will focus on expanding acrylic fiber capacity. Domestic capacity, now estimated at about 60,000 metric tons, will be almost tripled by 1990. A 50,000-ton plant is already under construction in Daqing. Import substitution—particularly with the prospect of rising prices—is probably the motive for this planned expansion. China is a major importer of acrylic fiber—80,000 tons in 1983, 120,000 tons in 1984, and perhaps 200,000 tons this year. Beijing expects imports of all synthetic fibers to increase by 20 to 25 percent this year. [redacted] 25X1

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China Buys $150 Million Worth of Coal Equipment From Italy

China signed a contract last week with Italy for $150 million worth of coal extraction equipment. The deal will be financed under a $500 million low interest export credit Rome recently provided for the development of southwestern China's coal mines, railways, and port facilities. Italy is also providing technical assistance. The contract is among China's largest for coal equipment and comes on the heels of a $126 million loan from the World Bank to build coal facilities. Beijing hopes to utilize foreign equipment and technology to expand coal output by the year 2000 to 1,200 million metric tons, a 55-percent increase over current production.

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